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SUBJECT: MARKETS RALLY ON IMF/INFLATION NEWS

1. (SBU) Turkish markets rallied Monday and Tuesday on the back of good inflation news and the IMF Board's August 1 decisions to approve the 5th Review and extend 2004-2005 Turkish repurchases. The lira strengthened to 1.406 million/dollar, yields on the benchmark August 8, 2004 t-bill dropped to 43.64 percent, and the stock market rose eight percent to 11,499.89. Amid much good news, the markets shrugged off Moody's August 5 announcement that it was not considering an upgrade of its currently negative outlook on Turkey.

2. (SBU) The State Statistical Institute announced over the weekend that the Consumer Price Index (CPI) fell 0.4 percent in July, while the Wholesale Price Index (WPI) dropped 0.5 percent. Analysts had expected CPI to increase slightly and WPI to hold steady. Declining food and clothing prices, which usually soften in the summer due to seasonal factors, were the driving force behind the drop in the indexes, along with the continuing strength of the lira. The drop in prices has prompted several analysts to predict another Central Bank rate cut, adding to the positive momentum in the markets.

3. (SBU) Markets welcomed the Fund's decision to extend Turkey's 2004-2005 repurchases, which should reduce the country's debt service load by nearly \$7 billion over the next two years. Although most analysts had expected some kind of "roll over," few expected the Fund's decision to be made this soon and to include 2005 as well as 2004 payments. Today, State Minister Babacan told the press that the Fund's decision would ease Turkey's debt burden over the next two years, and also announced that Treasury officials would travel to Washington August 18 to discuss U.S. assistance. There were, he said, no impediments to the U.S. release of \$8.5 billion in loans.

4. (SBU) Separately, Parliament passed late last week legislation that should strengthen BRSA's hand in dealing with Imar Bank and potentially other bank fraud cases. The legislation includes provisions that:

-- authorize the Council of Ministers to determine the principles and methods to be used by the Savings Deposit Insurance Fund (SDIF) to pay legitimate deposits of banks that are being liquidated;

-- in cases where banking regulators determine that the amount of bank deposits exceed the amount of deposits the bank has officially declared (such as in the Imar Bank case), criminal courts -- upon the recommendation of SDIF -- are authorized immediately to freeze an equivalent amount of the assets of bank owners and managers, including branch managers, and their families. Depending on the results of further investigation, SDIF could be authorized to seize assets sufficient to cover the difference between declared and actual deposits;

-- makes anyone who uses false documents to file a fraudulent claim for deposits in a taken-over bank subject to imprisonment for 4-8 years. plus a fine equal to ten times the amount received from the bank.

5. (SBU) At first glance, this legislation appears to be very similar to that sought by BRSA President Akcakoca. We will report further details after discussing this with BRSA.

